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No. 89-1283

IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,
v.
OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether the lower court erroneously failed to accord any deference to agency interpretation of a statutory scheme, where

   (a) the scheme consists of two statutes (the Federal Power or FPA and the Public Utility Holding Company Act or PUHCA), administered by two agencies (the Federal Energy Regulatory Commission or FERC and the Securities and Exchange Commission or SEC, respectiveiy), which function together to regulate interstate public utility holding companies; and

   (b) the lower court's ruling as to the jurisdiction of each agency is inconsistent with the manner in which both agencies have interpreted and administered the relevant statutory provisions since the FPA and PUHCA were enacted more than half a century ago.

2. Whether the lower court erroneously interpreted FPA Section 318 and PUHCA Section 13(b), through misapplication of preemption principles and this Court's decision in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), in holding that the FERC is without jurisdiction to ensure that the rates of a public utility affiliated with a holding company include only just and reasonable payments made to affiliated suppliers of fuel and other goods and services used to produce electricity, even when the SEC has not scrutinized or determined the reasonableness of those purchases.

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BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

The Indiana Municipal Power Agency (IMPA), pursuant to Rule 37 of the Rules of the Supreme Court of the United States, hereby submits this brief as *amicus curiae*, in support of the Petitioners in this proceeding, the Village of Arcadia, Ohio, *et al.* IMPA seeks reversal of the decision below, *Ohio Power Company v. FERC*, 880 F.2d 1400 (D.C. Cir. 1989).[1]

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[1] Consent of the parties is not required for the filing of this brief, because IMPA is a political subdivision of the State of Indiana, and IMPA is represented here by its General Counsel as well as by outside counsel (Rule 37.5).

INTEREST OF THE INDIANA MUNICIPAL POWER AGENCY

IMPA was formed as a political subdivision of the State of Indiana, pursuant to Indiana Code § 8-1-2.2, to serve as an electric power supply and planning agency for municipalities which own and operate retail electric distribution systems. IMPA currently consists of 31 Indiana cities and towns.[2] IMPA purchases wholesale electric power from Indiana Michigan Power Company (I&M), which is an operating company subsidiary of the American Electric Power Company, Inc. (AEP). AEP is a registered public utility holding company subject to the jurisdiction of the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act (PUHCA). I&M's wholesale rates to IMPA are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC) under the Federal Power Act (FPA).

The opinion below addressed the respective jurisdictions of the FERC and the SEC regarding the regulation of the cost of coal purchased by another operating company subsidiary of the AEP system, Ohio Power Company (Ohio Power), from a fuel subsidiary. The panel majority concluded that Section 318 of the FPA, 16 U.S.C. § 825q, deprives the FERC of jurisdiction to disallow that portion of the payments made by Ohio Power to its subsidiary which was in excess of the price of comparable coal in the market, when Ohio Power sought to include the cost of the payments in its wholesale electric rates.

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[2] The members of IMPA are the cities and towns of Advance, Anderson, Bainbridge, Bargersville, Centerville, Columbia City, Covington, Crawfordsville, Darlington, Edinburgh, Flora, Frankfort, Frankton, Greendale, Greenfield, Jamestown, Ladoga, Lawrenceburg, Lebanon, Linton, Middletown, Paoli, Pendleton, Peru, Renssalaer, Richmond, Rising Sun, Scottsburg, Tipton, Washington and Waynetown, Indiana.

Inter-affiliate transactions can be a significant component of the costs of a public utility holding company. For example, AEP, through its operating companies, has invested not only in affiliate coal mining operations, but in related fuel supply equipment and facilities, including a fleet of river towboats, approximately 500 coal barges, more than 3000 rail-hopper cars for transporting coal, and a rail-to-barge coal transfer terminal on the Ohio River with the capacity of transferring in excess of 12 million tons of coal annually. As a purchaser from an operating company subsidiary of a registered public utility holding company, IMPA has a direct interest in preventing the imposition of unwarranted restrictions upon the exercise by the FERC of its jurisdiction to regulate the wholesale electric rates of such operating company subsidiaries for the protection of consumers.

INTRODUCTION AND SUMMARY OF ARGUMENT

In the opinion below, the majority vacated a decision of the FERC, reached after a full adjudicative hearing and on the basis of an extensive record, disallowing in Ohio Power's wholesale rates a portion of the payments made to its affiliated coal supplier, Southern Ohio Coal Company (SOCCO), because the price substantially exceeded the market price of comparable coal available from non-affiliated suppliers. The FERC concluded that this disallowance was necessary to ensure that Ohio Power's rates were just and reasonable, pursuant to Sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d and 824e, because the utility had incurred unreasonable and excessive fuel costs by purchasing coal from an affiliate. Relying on its earlier determination in *Public Service of New Mexico*, 17 F.E.R.C. ¶ 61,123 (1981), *aff'd*, 832 F.2d 1201 (10th Cir. 1987), the FERC explained that the application of a market-price test protects ratepayers from costs of self-dealing without requiring detailed scrutiny of the affiliate transactions themselves, and provides an incentive for utilities to develop lower-cost sources of fuel. *Ohio Power*

Co., 39 F.E.R.C. ¶ 61,098 at pp. 61,278-79 (Pet. Cert. App., pp. 42a-43a).[3] *See also* the initial decision of the FERC Administrative Law Judge in the *Public Service Co. of New Mexico* proceeding, which observed that a utility's fuel purchases from affiliates should be subjected to a market-price test because "public utilities are required to operate with all reasonable economies and exclude expenses which are unnecessary, inefficient, or imprudently incurred." 13 F.E.R.C. ¶ 63,041 at p. 65,171 (1980) (*citing Acker v. United States*, 298 U.S. 426 (1936); *El Paso Natural Gas Co. v. FPC*, 281 F.2d 567 (5th Cir. 1960)).

In several orders issued prior to the FERC's rate opinion, the SEC had approved Ohio Power's injection of capital into and transfer of assets to SOCCO, in order to develop certain coal reserves. The orders were issued under sections of PUHCA requiring SEC approval for most changes in corporate structure, transfers of assets, and issuances of securities by registered holding companies and their affiliates. The SEC did not cite Section 13(b) of PUHCA, 15 U.S.C. § 79m, as authority for any of the orders. It did note that under that provision SOCCO's price for coal sold to Ohio Power would be "based on" or would "not exceed" SOCCO's actual costs. 880 F.2d at 1404 (Pet. Cert. App., pp. 5a-6a). In one order, the SEC required the companies to file information on amounts of coal sold, and the price and cost. *Id.* The SEC, however, never addressed the issue which was the basic subject of the subsequent FERC proceeding: the coal supply alternatives available to Ohio Power and the reasonableness of purchasing coal from SOCCO in light of the price of that coal (*i.e.*, SOCCO's cost of producing it) and the market alternatives. Nor was that matter even raised in the summary SEC proceedings.

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[3] "Pet. Cert. App." refers to the Appendices to the "Petition for a Writ of Certiorari . . ." filed by the Village of Arcadia, Ohio, *et al.* on February 9, 1990.

In response to Ohio Power's argument that Section 318 of the FPA precluded disallowance of any of its affiliated coal costs, the FERC concluded that the SEC's orders and PUHCA Section 13(b) did not affect its ability to set just and reasonable rates for Ohio Power, and that in any event there was no conflict between the SEC's orders and the FERC's application of the market-price test. 39 F.E.R.C. at pp. 61,276-78 (Pet. Cert. App., pp. 36a-40a). Judge Mikva scrutinized the SEC orders and also found no conflict. 880 F.2d at 1411-12 (Pet. Cert. App., 21a-23a). The majority below ruled, however, that the FERC was required to permit Ohio Power to charge its ratepayers for the full cost of the SOCCO coal, regardless of what action had been taken by the SEC, and regardless of whether the SEC took any action.

The majority held that the FERC, by disallowing from Ohio Power's rates the above-market portion of the price paid to SOCCO, had addressed the same "subject matter" as PUHCA Section 13(b): "[t]he price term of sales contracts between associated companies." 880 F.2d at 1406 (Pet. Cert. App., p. 9a). According to the court, therefore, Ohio Power was subject to both a requirement of PUHCA (Section 13(b)) and a requirement of the FERC under the FPA, as to that subject matter. The court concluded that the language of FPA Section 318 operates to divest the FERC of jurisdiction, whether or not the SEC has issued any order that actually conflicts with a FERC action. *Id.* at 1408 (Pet. Cert. App., pp. 14a-15a).

To support its analysis, the majority below analogized to this Court's preemption holdings in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). On the basis of those cases, and a broad reading of PUHCA Section 13(b) as delegating to the SEC the task of protecting electric consumers from unreasonable inter-affiliate transactions

within registered holding company systems,[4] the court concluded that FERC disallowance of any portion of the cost of inter-affiliate transactions would constitute an impermissible "trapping" of costs which are only subject to regulation by the SEC. 880 F.2d at 1406, 1409 (Pet. Cert. App., pp. 9a-11a, 16a-17a).

The lower court's decision should be reversed. It overturns a half century of the administration of PUHCA by the SEC and the administration of the FPA by the FERC.[5] Both agencies have consistently adopted the view that the FERC is not ordinarily barred by FPA Section 318 from disallowing, as excessive, imprudent, or otherwise unreasonable, costs incurred pursuant to a utility's purchases of goods and services from an affiliate within a registered holding company system. The SEC has generally confined itself under PUHCA Section 13(b) to a comparison of the affiliate supplier's price with that supplier's costs. It has not asserted or exercised jurisdiction over the broader question typically considered by the FERC and, in the case of retail rates, by the state commissions: whether it is reasonable for the holding company's operating subsidiary to engage in a transaction given the alternatives. If allowed to stand, the decision below threatens to create a substantial regulatory gap which will injure consumers of electricity across the Nation. Indeed, the harm resulting from the ruling below may extend beyond inter-affiliate transactions in goods and services; the court's reasoning implies that the FERC and state commissions are divested of jurisdiction to regulate any "subject matter" which is identified in PUHCA, regardless of what action has or has not been taken by the SEC.

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[4] Except for sales of electricity and natural gas, which are exempted from SEC regulation under PUHCA Section 2(a)(20), 15 U.S.C. § 79b(a)(20).

[5] And the FERC's predecessor, the Federal Power Commission.

IMPA respectfully submits that the lower court's willingness to brush aside a regulatory scheme that has been developed over 50 years, by two agencies working in concert, is contrary to the teaching of *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

Even if no deference is accorded to the SEC's and the FERC's consistent administration of the statutes, the lower court's interpretation of FPA Section 318 and PUHCA Section 13(b) is implausible. In essence, the court read PUHCA Section 13(b) as conferring exclusive jurisdiction on the SEC to determine the reasonableness, for ratemaking purposes, of Ohio Power's acquisition of fuel from affiliates. IMPA submits that the statutes cannot reasonably be interpreted as delegating to the SEC rather than the FERC jurisdiction over that subject matter, or over any subject matter which is an essential part of the rate-making process. The majority's use of *Nantahala Power & Light Co. v. Thornburg*, *supra*, is based on an incorrect analogy between the FERC (in its relation to state retail commissions) and the SEC (in its relation to the FERC). Congress delegated the regulation of public utility holding companies to two federal agencies, with jurisdiction over largely distinct but complementary subject matters: the SEC, with principal responsibility over corporate structure and financings, and the FERC, with principal responsibility over utility rates, services and operations in interstate commerce. Section 318 serves the function in this system of ensuring that inconsistent requirements are not imposed on any person by the SEC and the FERC, as to subject matters over which they have concurrent jurisdiction. That provision divests the FERC of jurisdiction when there is an actual conflict with a requirement of PUHCA or the SEC. *Cf. Northwestern Electric Co. v. FPC*, 321 U.S. 119, 125 (1944).

Reasonably interpreted, Section 13(b) of PUHCA and the SEC's rules and orders do not impose any requirement

on Ohio Power which invalidates the FERC's orders under FPA Section 318. Even if Section 13(b) is read to impose obligations on Ohio Power rather than on SOCCO alone, the subject matter addressed by that provision, and by the SEC in its regulations and orders addressing the SOCCO-Ohio Power relationship, is not the same as the subject matter addressed by the FERC in determining the reasonableness of Ohio Power's rates. Alternatively, as concluded by Judge Mikva below, even if PUHCA Section 13(b) and the FERC addressed the same subject matter, they did so in a consistent manner, because Section 13(b) and the SEC's rules and orders at most set a ceiling on the price of SOCCO coal.

ARGUMENT

I. THE DECISION BELOW UPSETS 50 YEARS OF SEC AND FERC/FPC DECISIONMAKING

The lower court concluded that it should not defer to the FERC's interpretation of FPA Section 318 because what was at issue was that agency's jurisdiction. 880 F.2d at 1405 (Pet. Cert. App., p. 8a). However, the majority's action was more radical than this characterization might suggest. The court disregarded the interpretation of FPA Section 318 and PUHCA Section 13(b) that has consistently been employed by *both* agencies entrusted by Congress with administering the statutes it enacted simultaneously in 1935.

The FERC's view that its mandate to ensure just and reasonable rates includes the power and the obligation to scrutinize holding company inter-affiliate payments is not of recent vintage. Prior to the development of the market-price test that was applied to Ohio Power, the FERC's predecessor, the FPC, required public utilities to eliminate from their books and their rates excessive payments made to supplier affiliates. The FPC's "no

profits to affiliates" rule was applied to operating utilities within holding company systems, even though sales to such utilities by affiliated service companies and fuel suppliers were subject to regulation by the SEC under PUHCA. *E.g., California Oregon Power Co. v. FPC*, 150 F.2d 25, 27-28 (9th Cir. 1945), *cert. denied*, 326 U.S. 781 (1946).[6]

In opposing the petition for certiorari, Ohio Power acknowledged the FERC's authority to eliminate profits to affiliates from rates, and argued that the FERC's orders under review were invalid under FPA Section 318 because a market-price rather than cost standard was applied to the Ohio Power-SOCCO transactions. Brief in Opposition of Respondent Ohio Power Company, March 12, 1990, at 11 & nn.7-8. *See also id.* at 9. However, the lower court held not that the FERC used an incorrect standard in assessing the justness and reasonableness of Ohio Power's payments to its affiliate, but that the FERC lacked jurisdiction over that subject matter.

The majority below incorrectly concluded that the SEC's pronouncements are consistent with ousting the FERC of jurisdiction to disallow the cost of holding company affiliate fuel purchases in rates. To the contrary, in numerous orders stretching from the 1940's through the 1980's, the SEC has taken the view that it is the FPC/FERC, and not itself, that has jurisdiction to determine whether costs incurred by public utilities pursuant to intra-holding company transactions subject to SEC jurisdiction under PUHCA should be reflected in rates.

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[6] The FPC originally developed the "no profits to affiliates" rule in the early 1930's, in regulating hydroelectric licenses under the Federal Water Power Act of 1920 (now Part I of the FPA). After the enactment of the Public Utility Act of 1935, the FPC applied this rule to the regulation of interstate electric utilities. *California Oregon Power Co. v. FPC*, 150 F.2d at 27.

In *Central and South West Fuels, Inc.*, Holding Company Act Release No. 23,876, 34 S.E.C. Docket 500 (Oct. 23, 1985), the SEC considered a proposal by electric utility subsidiaries of the Central and South West Corporation to dissolve a fuel subsidiary and transfer its functions to the service company for the holding company system. In response to a concern expressed by intervenors that inflated fuel prices might result, the SEC expressly acknowledged the FERC's continuing jurisdiction:

> [N]othing in the proposed transactions will alter the statutory and regulatory pricing restrictions applicable to the sale of fuel to, or the performance of services for, affiliated operating companies. Such restrictions will continue to apply . . . as fully as they have applied . . . in the past. For example, Rules 90 and 91 [promulgated under PUHCA] limit charges for sale or services by an affiliated company to cost; Paragraph E of Section 23.23 of the Substantive Rules of the Public Utility Commission of Texas expressly limits affiliate fuel pricing to cost; and similarly, with respect to wholesale rates, under Section 35.14 of the regulations of FERC, unreasonable fuel charges by affiliated companies may result in the suspension of the fuel adjustment clause or cause an investigation by FERC on its own motion.

34 S.E.C. Docket at 503. In approving requests in the 1940's by Ohio Power and an affiliated public utility to establish a coal subsidiary, the SEC noted that its actions did not preclude ratemaking authorities from scrutinizing the transactions in question for purposes of setting rates. *Appalachian Electric Power Co.*, 27 S.E.C. 1029, 1034-35 (1948).[7] *Accord, The North American Co.*, 29 S.E.C. 521, 537 n.26 (1949) (in ruling that a holding company could retain its coal subsidiary, the SEC noted that coal

[7] The SEC added that it had the authority, under PUHCA Section 13, to take further action in the future if it determined that such action was necessary to enforce the standards of PUHCA or to protect consumers or investors. 27 S.E.C. at 1035.

prices would be scrutinized by ratemaking authorities and added that it could take action under Section 13 and other provisions of PUHCA at a later date if necessary).

In the proceeding below, the FERC relied on SEC statements in *New England Electric System*, Holding Company Act Release No. 22,309, 24 S.E.C. Docket 298 (Dec. 9, 1981), regarding a joint venture between a registered holding company and two subsidiaries to construct and operate coal transportation facilities. The lower court distinguished this case on the grounds that the SEC's discussion of the FERC's authority may have been predicated on the grant of an exemption under PUHCA Section 13(b). 880 F.2d at 1407 (Pet. Cert. App., pp. 12a-13a). This reading is incorrect. The SEC concluded that, because FERC's ratemaking jurisdiction is *independent* of PUHCA, no harm to consumers would result from a grant of exemption from PUHCA Section 13(b). The SEC stated, "Our grant of the exemption does not affect FERC's authority over rates . . .", and also observed that, in setting the wholesale rates of an operating subsidiary purchasing the transportation services, the FERC "may include either the entire cost of transportation . . ., if FERC should determine that it is just and reasonable, or some other amount." 24 S.E.C. Docket at 307-08, quoted in 39 F.E.R.C. at pp. 61,277-78 (Pet. Cert. App., pp. 39a-40a). The SEC added that the determination of the just and reasonable transportation costs of the operating utility was not its task, but FERC's: "In relying on this [FERC] ratemaking process we do not cede any of our statutory responsibilities to another agency." 24 S.E.C. Docket at 308, quoted in 39 F.E.R.C. at p. 61,278 (Pet. Cert. App., p. 40a).[8]

[8] By contrast, when the FERC approved a settlement of litigation regarding the payments by another operating utility affiliate of Ohio Power for affiliate-supplied coal, there was a conflict with PUHCA Section 13(b) because the settlement agreement specified that the coal affiliate's prices for coal sold to the utility would be based upon market prices, which were expected to exceed the coal

In *Georgia Power Co.*, Holding Company Act Release No. 23,448, 31 S.E.C. Docket 621 (Oct. 10, 1984), the SEC approved a sale of an ownership share of a generating plant under construction from one operating utility (Georgia Power Company) to another (Gulf Power Company) within the Southern Company registered holding company system. The SEC observed that, because Georgia Power would continue to construct the plant, the transaction would involve an inter-affiliate supply of construction services subject to PUHCA Section 13(b). 31 S.E.C. Docket at 623. In response to allegations by a group of retail ratepayers that Georgia Power's construction program was unreasonable and too costly, the SEC observed "that in a recent decision the Georgia [Public Service] Commission stated that . . . it will review Georgia [Power]'s construction program, and our decision today does not limit the extent of that review nor what [retail ratepayers] may submit to the Georgia Commission." *Id.* at 624 (footnote omitted).

Consistent with its interpretation of its own and the FERC/FPC's jurisdiction, the emphasis of the SEC's activities under PUHCA Section 13(b) has been to prevent suppliers affiliated with operating utilities in registered holding company systems from charging prices to those utilities in excess of the affiliates' costs. To the best of the knowledge of undersigned counsel, the SEC has only considered the broader question of the need for goods or services to be purchased by an operating utility from an affiliate, given alternative sources of supply, in the context of determining whether to approve the establishment or permit the continued existence of a service company within a holding company system (an entity supplying managerial, engineering, legal and other services to the

affiliate's costs. To eliminate the conflict and effectuate the FERC settlement under FPA Section 318, the AEP companies applied for and were granted a limited exemption from Section 13(b) by the SEC. *Blackhawk Coal Co.*, Holding Company Act Release No. 23,834, 34 S.E.C. Docket 185 (Sept. 20, 1985).

operating utilities).[9] With regard to particular transactions between affiliates, the SEC has left questions of their reasonableness to the FERC/FPC and state rate commissions.[10]

In other decisions, the SEC has observed that its jurisdiction over financing vehicles under PUCHA does not operate in conjunction with FPA Section 318 to divest the FERC or state ratemaking agencies of their authority to disallow the related costs in setting just and reasonable electric rates. *E.g., Georgia Power Co.*, Holding Company Act Release No. 18,750, 5 S.E.C. Docket 24, 25 (Dec. 31, 1974) (SEC approval of a partial sale of a nuclear plant by an operating utility subsidiary of the Southern Company does not prevent rate commissions from scrutinizing the reasonableness of the sale price under FPA Section 318); *Arkansas Power & Light Co.*, 45 S.E.C. 567, 573-74 (1974) (SEC approval of a sale and leaseback of nuclear fuel does not compel retail rate agencies or the FPC to allow the cost of the fuel in rates).

[9] *E.g., New England Power Service Co.*, 10 S.E.C. 562 (1941).

[10] The lower court relied on an SEC statement made, in the course of advocating repeal of PUHCA, in a 1982 hearing before the House of Representatives (880 F.2d at 1407; Pet. Cert. App., p. 13a). That statement must yield to the manner in which the SEC has actually administered PUHCA. Contrary to the assertion of Ohio Power (at pages 15-16 of its brief in opposition to certiorari), the fact that Congress did not amend or repeal PUHCA on the basis of this SEC statement is entitled to no weight in determining the intent of the statutory scheme established in 1935. *See Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. ——, 109 S.Ct. 948, 956 (1989), where the Court declined to infer, from a failure of Congress to amend a statute to reverse an interpretation of the statute that had been adopted by almost all of the Courts of Appeals, that the lower courts' interpretation was correct. In the controversy at bar, Congress' inaction regarding PUHCA in the early 1980's is much less significant than the Congressional inaction at issue in *Firestone Tire*, because the SEC's 1982 statement on Sections 13(b) of PUHCA and 318 of the FPA was inconsistent with its actual administration of PUHCA.

In *AEP Generating Co.*, Holding Company Act Release No. 24,989, 44 S.E.C. Docket 1665 (Nov. 21, 1989), two affiliates of Ohio Power sought SEC approval of a sale and leaseback of their ownership shares of a new coal-fired generating unit, and payment by one affiliate to the parent holding company of a portion of the sale proceeds as a dividend to reduce the holding company's equity investment. The AEP companies admitted that SEC approval would not preclude the FERC from considering the reasonableness of the costs and benefits of the dividend transaction, or of the affiliates' capital structure or capital costs, and would not preclude the FERC from making cost disallowances for ratemaking purposes (so long as the FERC did not alter the specific debt interest rates, preferred stock dividend rates, and accounting treatment approved by the SEC). 44 S.E.C. Docket at 1667.

The SEC also has declared in a number of cases that its jurisdiction over security issuances and transfers of ownership shares in utility plant under PUHCA does not extend to assessments of the reasonableness of an operating utility's construction program. The agency has referred utility customers seeking to challenge the costs incurred as a result of a construction program, or the allocation of such costs among holding company system members, to the FERC/FPC or the appropriate state retail rate commission. *E.g., Georgia Power Co.*, 31 S.E.C. Docket at 624; *Georgia Power Co.*, Holding Company Act Release No. 23,330, 30 S.E.C. Docket 934, 935-36 (June 15, 1984); *The Southern Company*, Holding Company Act Release No. 21,665, 20 S.E.C. Docket 739, 801-02 (July 24, 1980); *Georgia Power Co.*, 5 S.E.C. Docket at 25. The power of the FERC/FPC to disallow such costs in the context of an inquiry into the reasonableness of a construction program has not been affected by its lack of jurisdiction,

pursuant to FPA Section 318, to approve or deny the security transaction or asset disposition or acquisition itself.[11]

The above cases present a consistent SEC interpretation of its jurisdiction under PUHCA and the FERC/FPC's jurisdiction under the FPA. With regard to inter-affiliate sales subject to PUHCA Section 13(b), and financings of new plant and transfers of plant shares subject to other provisions of PUHCA, the SEC has exercised jurisdiction over the specific sale, security issuance or other transaction addressed by PUHCA, and has left to the FERC/FPC (or the appropriate state commission, with regard to retail rates) scrutiny of the larger questions of whether the activities of operating utilities in obtaining fuel and constructing generation resources have been reasonable and have avoided unnecessary costs to ratepayers. These cases are inconsistent with the decision of the lower court in the instant case. Under the D.C. Circuit's interpretation of FPA Section 318, the FERC would be divested of jurisdiction to disallow, for ratemaking purposes, costs incurred pursuant to any transaction which is specifically identified in Section 318 —including securities transactions and acquisitions and dispositions of assets—as well as transactions such as inter-affiliate sales of coal, which are "other subject matters" identified in PUHCA.[12]

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[11] *See, e.g., Gulf Power Co.*, Holding Company Act Release No. 21,419, 19 S.E.C. Docket 506 (Feb. 5, 1980); *Oklahoma Gas and Electric Co.*, 5 F.P.C. 52, 54 (1946) (SEC jurisdiction over a securities issuance by a holding company affiliate under PUHCA divested FERC/FPC of jurisdiction under FPA Section 204 to approve or deny it); *Monongahela Power Co.*, Holding Company Act Release No. 16,423 (July 8, 1969); *Kentucky Power Co.*, Holding Company Act Release No. 15,905 (Nov. 24, 1967) (where a utility's sale of assets is subject to SEC approval under PUHCA, the FPC does not have jurisdiction under FPA Section 203 over that sale, although it would have jurisdiction over the acquisition of the assets by an independent company).

[12] PUHCA Section 13(b)'s requirement that the SEC regulate sales of goods and services to affiliates "in the public interest [and]

Thus, the SEC has not interpreted its jurisdiction under PUHCA as extending to issues pertaining to whether a utility has acted reasonably to supply electric service to wholesale or retail customers at a just and reasonable cost, such as whether it has incurred unnecessary fuel costs as a result of self-dealing or poor planning, or has failed to take reasonable steps to avoid unnecessary costs in developing new generation resources. Even if the SEC's jurisdiction extends to such subject matters, however, the lower court's interpretation of FPA Section 318 as divesting the FERC of jurisdiction over any subject matter identified in Section 318 or in PUHCA, for purposes of determining just and reasonable rates, clashes with the way the SEC and the FERC/FPC have regulated electric utilities within registered holding company systems. For instance, both the SEC and the FPC/FERC have required holding company system utilities to eliminate from their books unreasonable write-ups of assets and profits to affiliates, to prevent use of the holding company structure to overcharge customers. *E.g., Georgia Power Co.*, 31 S.E.C. Docket at 623 & nn. 11-15, and cases there cited. In litigation before this Court over the FPC's authority to require an operating utility holding company subsidiary to revise its accounts to eliminate write-ups in the value of its common stock from its cost of plant, the SEC stated, in a letter to the Solicitor General:

> Section 318 of the Public Utility Act of 1935 resolves the question of possible conflicting requirements . . . . It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up under Sec. 318 imaginary conflicts with *potential* action of the S.E.C.

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for the protection of investors [and] consumers" (15 U.S.C. § 79m) also appears in the provisions governing SEC regulation of security transactions and transfers of assets. PUHCA Sections 6(b); 7(d) and (e); 9(c); 10; and 12(c), (d), (f) and (g) (15 U.S.C. §§ 79f (b); 79g(d) and (e); 79i(c); 79j; and 79*l*(c), (d), (f) and (g)).

Letter from G. Purcell, Chairman, SEC, to the U.S. Solicitor General, December 10, 1943, printed in Brief of Respondent, App. D at 98-99, *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944) (No. 195) (emphasis in original).

In cases presenting issues of overlapping SEC and FERC/FPC jurisdiction, the SEC has taken care to fashion or modify its orders to avoid unnecessary interference with FERC/FPC authority under Section 318. *E.g., American Power & Light Co.*, Holding Company Act Release No. 9719 (March 7, 1950) (modification of prior SEC order to eliminate condition which might have limited the FPC's jurisdiction under FPA Section 204 to approve securities); *Oklahoma Gas and Electric Co.*, 22 S.E.C. 209, 219 (1946); *Oklahoma Gas and Electric Co.*, 22 S.E.C. 466 (1946) (SEC granted approval of amortization program for premiums paid on redemption of preferred stock as ordered by the FPC, to avoid affecting that agency's jurisdiction). In *Blackhawk Coal Co., supra* n.8, the SEC granted a limited exemption from PUHCA Section 13(b) in order to effectuate a settlement of FERC litigation involving the reasonableness of purchases by Indiana & Michigan Electric Company (I&M), an affiliate of Ohio Power, from a subsidiary coal supplier, Blackhawk Coal Company, in light of the availability of lower-cost coal from nonaffiliates. Under the settlement, Blackhawk was permitted to purchase coal from nonaffiliates and sell it to I&M at specified market-based prices; the excess of I&M's payments over Blackhawk's costs were to be used to amortize a portion of the investment in the Blackhawk mines. In the instant case, the Court of Appeals in effect declared that neither the FERC nor the SEC possesses the authority to take the actions that they took in the *Blackhawk* case. *See* 880 F.2d at 1408 (Pet. Cert. App., p. 15a).[13]

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[13] Unlike the FERC orders at issue in this case, the FERC settlement at issue in *Blackhawk Coal Co.* conflicted with PUHCA Section 13(b), because it provided that Blackhawk would charge and

IMPA respectfully submits that even if, as a general matter, an agency's interpretation of its statutory jurisdiction is not entitled to judicial deference, the lower court erred in this case by failing to accord any deference to this regulatory history. Judicial deference to an agency's interpretation of a statute that it administers is grounded in the principle that a reviewing court should not interfere with the authority delegated to the agency to develop the details of an administrative scheme and to develop policy within the parameters set by Congress. *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. at 843-44. The majority's ruling disrupts a regulatory system fashioned by two agencies over a 50-year period, in which the SEC, in exercising its powers under PUHCA, generally has deferred to and relied upon the FERC's or FPC's power, in setting rates, to disallow costs incurred by operating utility subsidiaries of holding companies as unjust and unreasonable. Moreover, the FERC's and SEC's longstanding implementation of FPA Section 318 and PUHCA Section 13(b) is entirely consistent with the plain meaning of those statutes.

II. THE DECISION BELOW DOES VIOLENCE TO THE STATUTORY SCHEME AND DISTORTS THIS COURT'S PRIOR HOLDINGS

The lower court rested its decision on an extremely broad and unreasonable reading of FPA Section 318 and PUHCA Section 13(b). Analogizing to the doctrine of "preemption of the field," which has been applied to bar state regulation of a subject matter which Congress intended be subject only to federal regulation, the lower court concluded that Congress intended to divest a *federal* agency, charged with ensuring just and reasonable electric rates, of jurisdiction to determine whether and to what ex-

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I&M would pay market-based prices for coal in excess of Blackhawk's costs.

tent ratepayers should bear the costs of intra-holding company transactions in fuel and other goods and services used to produce electricity. This conclusion is contradicted by the very fact that, in the 1935 Public Utility Act, Congress established a system to regulate interstate electric utilities consisting of *two* statutes and *two* agencies, with interlocking and complementary powers. The SEC was given principal authority over utility corporate structure and financing, and the FERC (formerly the FPC) was given principal authority over interstate utility operations and rates. *City of Lafayette, Louisiana v. SEC*, 454 F.2d 941, 955-56 (D.C. Cir. 1971), *aff'd on other grounds, Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973).[14] By giving the SEC broad powers over the organization and financial transactions of holding companies, Congress intended to supplement, not supplant, regulation of utility rates and services. *See Alabama Electric Cooperative v. SEC*, 353 F.2d 905, 907 (D.C. Cir. 1965). FPA Section 318 was necessary to resolve any actual conflicts that might arise between the two agencies as to matters over which they have concurrent jurisdiction. Congress addressed the general scope of the FERC's jurisdiction over interstate utility rates and services in Section 201 of the FPA (16 U.S.C. § 824), not in Section 318. *See, e.g.*, Section 201(b)(1) (limited jurisdiction over generating or distribution facilities or transmission facilities used only for intrastate commerce), and Section 201(f) (no jurisdiction over the United States, or a state, or any political subdivision of a state).

As pointed out by Judge Mikva below (Pet. Cert. App., p. 30a), the Court of Appeals decision creates a serious regulatory gap in the system designed by Congress and implemented by the FERC and the SEC. The

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[14] This Court quoted the *Lafayette v. SEC* analysis of the allocation of authority between the SEC and the FERC/FPC in *Gulf States Utilities Co. v. FPC*, 411 U.S. at 755 n.4.

majority observed that Ohio Power's coal costs had not been scrutinized or controlled by the SEC. 880 F.2d at 1408-09 (Pet. Cert. App., p. 15a). However, the gap is more severe than the lower court acknowledged. The SEC's orders regarding Ohio Power are no anomaly; the agency has not scrutinized interaffiliate sales and service transactions as though PUHCA Section 13(b) was a substitute for the reasonableness investigations conducted by the FERC (and state commissions) in the context of rate proceedings. In rejecting a "preemption of the field" analysis regarding regulation of rural electric cooperatives by state authorities, when the FERC had declined to regulate those entities, this Court observed that "Congress' purpose in 1935 [in enacting the FPA provisions regarding regulation of interstate electric utilities] was to fill a regulatory gap, not to perpetuate one." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 384 (1983) (footnote omitted). By divesting the federal agency entrusted with interstate electric rate regulation of jurisdiction over an important element of the rates of those utilities who belong to interstate holding company systems, the lower court created an outcome even more unreasonable than that rejected by the Court in *Arkansas Electric Cooperative Corp.* Moreover, although the court only purported to consider the wholesale ratemaking jurisdiction of the FERC, its analysis would appear to divest state commissions of jurisdiction over this aspect of retail rates as well.

The Court of Appeals reached this drastic result by means of the following analysis:

1. PUHCA Section 13(b), and the SEC's regulations thereunder, impose requirements on Ohio Power with regard to the price of SOCCO coal.

2. The FERC's market-price test also imposed a requirement on Ohio Power as to that same subject matter, because it resulted in a disallowance of a portion of the price paid by the utility.

3. Under FPA Section 318, the FERC cannot impose such a requirement.

The court's analysis is based on an implausible interpretation of both statutory provisions.

The wording of PUHCA Section 13(b) is strikingly different from Sections 205 and 206 of the FPA, which are the source of the FERC's authority to set just and reasonable rates. *Compare* 15 U.S.C. § 79m *with* 16 U.S.C. §§ 824d and 824e. It is well-established that statutes giving federal or state agencies the power to disallow unjust and unreasonable rates empower them to prohibit flow-through to consumers of excessive, unnecessary or imprudent costs. *Acker v. United States*, 298 U.S. at 430-31. When a utility or other service provider subject to such a statute engages in dealings with unregulated affiliates, a critical element in rate regulation is the scrutiny of such transactions and disallowance of excessive costs resulting from self-dealing. *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 607-08 (1945); *Western Distributing Co. v. Public Service Comm'n of Kansas*, 285 U.S. 119, 124-25 (1932). By contrast, Section 13(b) of PUHCA, on its face, applies only to a supplier of goods or services, such as SOCCO, not to a purchasing utility, such as Ohio Power. Even if the statute is read as applying to Ohio Power as well as to SOCCO, it only addresses one limited aspect of the larger issue with which the FERC was concerned in setting just and reasonable rates. Section 13(b) requires that sales of coal by SOCCO to Ohio Power, *if* they occur, must not be at a price greater than cost. The statute, however, does not address the question of whether and to what extent purchases by Ohio Power at SOCCO's price are reasonable in light of the price of coal available from other sources, including non-affiliated suppliers.

The lower court's claim that it was cognizant of the SEC's lack of ratemaking authority [15] is hollow. In essence, as the court's reliance on *Nantahala Power & Light Co. v. Thornburg, supra*, reveals, it has delegated an important component of ratemaking to the SEC. In *Nantahala*, this Court held that a state retail commission was preempted from regulating the price of wholesale electric power purchases by a retail utility, because that price was subject to a federal *ratemaking* authority: the FERC.[16]

In short, the most reasonable interpretation of the statute is that the FERC's orders are not beyond the scope of its jurisdiction under FPA Section 318, because PUHCA Section 13(b) does not impose any requirement on Ohio Power, at least with regard to the subject matter addressed by the FERC. That subject matter is *not* the price of SOCCO's sales to Ohio Power, but the reasonableness of Ohio Power's fuel costs in light of the options available to the utility.

In the alternative, even if Section 13(b) of PUHCA addresses, or authorizes the SEC to address, the same subject matter that was addressed by the FERC, the latter's orders are in no way inconsistent with the requirements of Section 13(b), the SEC's rules, or the SEC orders regarding the SOCCO-Ohio Power relationship. That FPA Section 318 does not invalidate a FERC order in the absence of a conflict with a specific PUHCA requirement is indicated by this Court's holding in *Northwestern Electric Co. v. FPC*, 321 U.S. at 125. Any other interpretation would be inconsistent with Congress' delegation to both the SEC and the FERC of authority over numerous subject matters regarding public utility holding company systems, including security issuances, asset transfers, and accounting.[17]

The specific SEC orders contain nothing inconsistent with the FERC's use of a market-price test to disallow

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[15] 880 F.2d at 1407 (Pet. Cert. App., p. 11a).

[16] The majority below attempted to draw a distinction between the FERC's regulation of the *price* of an inter-affiliate sale, which is barred by FPA Section 318, and its regulation of the *quantity* purchased given the price, which remains within the FERC's jurisdiction. 880 F.2d at 1409-10 (Pet. Cert. App., pp. 17a-18a). This distinction applies to the scope of permissible state regulation of retail rates when a utility purchases electricity or natural gas at a price subject to FERC ratemaking jurisdiction; it does not reflect the nature of the FERC's and the SEC's regulation of inter-affiliate transactions in registered holding company systems. The FERC applied the market-price test to Ohio Power in order to protect ratepayers from unreasonable purchases of coal from affiliates such as SOCCO when lower-priced alternatives were available. The SEC did not consider that issue at all.

[17] The lower court concluded that Congress had delegated regulation of inter-affiliate transactions solely to the SEC because Section 13(b) requires the SEC to ensure that inter-affiliate sales are "in the public interest [and in the interest of] investors [and] consumers and . . . that such contracts are performed economically and efficiently . . . at cost. . . ." (15 U.S.C. § 79m). 880 F.2d at 1406 (Pet. Cert. App., pp. 10a-11a). However, the SEC and the FERC/FPC jointly administer a number of the policies enumerated in PUHCA. For instance, one of the fundamental policies of PUHCA is to eliminate excessive charges for goods and services, and unreasonable write-ups of asset values, due to self-dealing within holding company systems. PUHCA Section 1(b)(2), 15 U.S.C. § 79a(b)(2). This policy has been administered by both the SEC and the FPC/FERC in their regulation of utility accounts. *Northwestern Electric Co. v. FPC, supra; California Oregon Power Co. v. FPC, supra; American Power & Light Co. v. SEC*, 158 F.2d 771 (1st Cir. 1946), *cert. denied*, 331 U.S. 827 (1947); *Georgia Power Co.*, 31 S.E.C. Docket at 623 & nn. 11-15, and cases there cited.

Another important policy underlying PUHCA is regulation of utility accounting to ensure accurate reporting to investors. Section 1(b)(1), 15 U.S.C. § 79a(b)(1). The enforcement of this policy by the FPC against an AEP operating utility, pursuant to the FPC's general jurisdiction over accounting, was upheld by the Court of Appeals for the Fourth Circuit because there was no actual conflict with any SEC requirement. *Appalachian Power Co. v. FPC*, 328 F.2d 237, 246-52 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964).

a portion of Ohio Power's payments to SOCCO. They merely note that SOCCO's price to Ohio Power would not exceed SOCCO's cost. Those orders at most set a ceiling, but not a floor, on SOCCO's charges and Ohio Power's payments. Even if the FERC's disallowance is conceived as regulating the price of the SOCCO coal, the FERC did not violate the SEC's ceiling. 880 F.2d at 1411-12 (Pet. Cert. App., pp. 21a-23a) (opinion of Mikva, J.).

Nor do the statute or the SEC's rules—17 C.F.R. §§ 250.90-250.92—impose any requirement on SOCCO or Ohio Power inconsistent with the FERC orders. They do not specify when purchases from an affiliate are reasonable, in light of the affiliate's costs and the prices of comparable goods or services available from other sources. To conclude that the intent of Section 13(b) was to establish that any inter-affiliate sale is just and reasonable as long as the price is based on the affiliate seller's cost, regardless of how excessive the costs of the transaction might be compared to the alternatives, would be inconsistent with the provision's requirement that affiliate sales to a utility such as Ohio Power be "performed economically and efficiently for the benefit of [the purchasing utility] at cost . . . ." 15 U.S.C. § 79m(b). It would also be inconsistent with the Congressional concern over self-dealing by holding company systems at the time that the Public Utility Act of 1935 was drafted and with the FPA's prohibition of unreasonable and excessive rates. As for the SEC's rules, they prohibit prices "at *more than* cost" (17 C.F.R. § 250.90 (a)(2), emphasis added), and impose *market-price* limitations on the sale of goods produced by the affiliate seller (§ 250.90(d)(2) and § 250.92(b)).

The Court of Appeals applied the doctrine of "trapped costs," articulated in *Nantahala Power & Light v. Thornburg* and *Mississippi Power & Light v. Moore*, to a federal regulatory ssytem where it has no applicability. Those cases teach that a state is preempted from trapping costs regulated by the FERC under the FPA—the price of wholesale electric power, and power costs allocated among utilities within a holding company system by means of wholesale power agreements—by disallowing them in retail rates. Under the federal regulatory system established by the Public Utility Act of 1935, however, the SEC's role is not analogous to the FERC's role in *Nantahala* and *Mississippi*. The FERC, the North Carolina Utilities Commission and the Mississippi Public Service Commission are ratemaking agencies which operate at different levels of commerce in electricity (interstate or intrastate). The SEC, on the other hand, traditionally has not asserted jurisdiction—and certainly does not possess *exclusive* jurisdiction—to assess the reasonableness of a utility's efforts to provide electric service to wholesale or retail customers at a just and reasonable price. In the Public Utility Act of 1935, Congress delegated jurisdiction over wholesale electric service to the FERC (then the FPC), and left jurisdiction over retail electric service to the states.[18] Unless the FERC (or a state commission) specifically countermands an order or regulation of the SEC, it does not "trap" any costs. Certainly in the case at bar, the FERC's orders did not disallow any costs that Ohio Power could reasonably have expected were immune from

[18] In *Nantahala*, the Court observed that the "filed rate doctrine" establishes the FERC's exclusive jurisdiction over wholesale electric transactions. 476 U.S. at 962-67. Under that doctrine and the FPA, utilities are obligated to file with the FERC tariffs specifying their wholesale rates and services, and all contracts affecting those rates and services, and are bound to adhere to those terms unless modified by the FERC. 16 U.S.C. § 824d(c) and (d); *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). The statute provides for public notice, FERC review of the reasonableness of tariffs and contracts filed, and refund protection from excessive rates. 16 U.S.C. §§ 824d(e) and 824e. Section 13(b) of PUHCA and the SEC's rules do not establish a system of filed tariffs and rate review. 880 F.2d at 1408 (Pet. Cert. App., p. 15a).

ratemaking scrutiny, in light of the history of SEC and FERC regulation.

CONCLUSION

The decision of the lower court should be reversed.

Respectfully submitted,

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